Supreme Court, U.S.
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No.

In the
Supreme Court of the United States

OCTOBER TERM, 1996

ERNEST J. CLAYTON ET AL., *Petitioners*

v.

THE UNITED STATES, *Respondent*

On Petition for a Writ Of Certiorari to the United States Court of Appeals for the Federal Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. When employees give up wages in exchange for employer contributions to a trust and a right to receive the contributions and any earnings thereon when their employment terminates, is the earnings component of what they receive treated as "compensation" to the employees for federal income tax purposes, an issue on which the circuit courts are now in conflict?

2. When Canadian employees receive payments from an employer-funded trust that include earnings on employer contributions to the trust, are the payments "salaries, wages and other similar remuneration" under the U.S.-Canada Tax Treaty?

PARTIES

The petitioners are Ernest J. Clayton, Gary C. Farfanick, Richard R. Reaume, Richard C. Thrasher, and George D. Wilson. The petitioners are citizens and residents of Canada.

The respondent is the United States of America.

The petitioners and the respondent were the parties to the proceedings below.

The respondent has entered into a settlement agreement with approximately 6,000 Canadian citizens, each of whom made the same type of tax refund claim as the petitioners, that binds them and the respondent to the results of this case.

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PETITION FOR WRIT OF CERTIORARI

Ernest J. Clayton, et al. petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit in this case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Federal Circuit (App. 1a-5a) is reported at 96-1 U.S.T.C. ¶ 50,314 (1996). The opinion of the United States Court of Federal Claims (App. 6a-77a) is reported at 33 Fed. Cl. 628 (1995).

JURISDICTION

The court of appeals entered its judgment on June 12, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTE AND TREATY INVOLVED

1. The Internal Revenue Code.

Section 862(a)(3) of the Internal Revenue Code, 26 U.S.C. § 862(a)(3), provides:

> The following items of gross income shall be treated as income from sources without the United States: . . . (3) *compensation* for labor or personal services performed without the United States; . . . .

2. The U.S.-Canada Tax Treaty.

Article XV of the Convention Between the United States and Canada with Respect to Taxes on Income and Capital, T.I.A.S. No. 11,087, 1986-2 C.B. 258, provides:

> Subject to the provisions of Article XVIII (Pensions and Annuities) and XIX (Government Service), *salaries, wages and other similar remuneration* derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State.

STATEMENT

The petitioners are Canadians who work in Canada for a subsidiary of Chrysler Corporation. In 1979 Chrysler was experiencing financial difficulties and obtained loan guarantees from the United States Government. A condition of the loan guarantees was that Chrysler employees, including petitioners, accept wage reductions. In turn, Chrysler was required to contribute shares of Chrysler stock to a trust for the benefit of each employee whose wages were reduced. Chrysler contributed stock to the trust during the period 1981-1984.

The trust was required to hold each employee's stock for as long as the employee worked for Chrysler or until the trust terminated. When an employee became entitled to a stock distribution he had the option of directing the trustee to sell the stock on his behalf.

The trust was terminated in 1985. Petitioners and thousands of other Chrysler employees elected to have the trustee sell their stock and send them the proceeds. Although the stock had been worth relatively little when it was contributed to the trust, by 1985 it had increased in value as a result of Chrysler's recovery. Approximately 85% of the stock sale proceeds received by petitioners were attributable to the appreciation that occurred while the stock was held in trust.

The trustee asked the Internal Revenue Service for a ruling that no withholding of tax was required. The Service ruled instead that United States income taxes should be withheld on the portion of the stock sale proceeds attributable to the stock's appreciation. The trustee complied with the ruling.

The petitioners and several thousand other Canadian autoworkers claimed refunds of the taxes that were withheld

from their distributions, but the claims were denied. The petitioners then filed a suit for refunds in the Court of Federal Claims, invoking that court's jurisdiction under 28 U.S.C. § 1346(a)(1) as a civil action for the recovery of an erroneously assessed internal revenue tax.

The petitioners sued on behalf of themselves and approximately 6,000 other Canadian autoworkers. Petitioners' motion for class certification was mooted by a settlement agreement between respondent and the other autoworkers that bound them to the outcome of petitioners' case.

A. The Internal Revenue Code Question.

The parties stipulated that petitioners were nonresident aliens who were not engaged in a United States trade or business. Consequently, they were taxable only as provided in section 871(a) of the Internal Revenue Code. I.R.C. § 2(d).

Under section 871(a) a nonresident alien is taxable only on income from sources *within* the United States. I.R.C. § 871(a)(1). If the income is "compensation for labor or services", the "source" of the income is the place where the labor or services are performed. I.R.C. §§ 861(a)(3), 862(a)(3)(supra at 2). Because the parties stipulated that petitioners had worked exclusively in Canada, it was undisputed that their distributions were not taxable if the distributions were "compensation for labor or services".

The courts' holding that the appreciation component of petitioners' distributions did not have the same character in the hands of petitioners as it did in the hands of the trustee was consistent with the decisions of other circuits. The Second, Fourth, Fifth, Sixth, and Eight Circuit has each decided one or more cases in which a taxpayer had performed

services, had received payments from a trust which the service recipient had funded, and had claimed that the payment attributable to trust earnings should not be taxed as compensation or wages, but should be taxed at a lower rate applicable to the trust earnings. In every case the court sustained the government's contention that the earnings component of the distributions was taxable as "compensation" or "wages".[1]

The opinion of the Court of Federal Claims acknowledged the decisions of the other circuits, but nevertheless held that the appreciation component of petitioners' distributions was not "compensation". The court premised its departure from the contrary precedents on the doctrine of "legislative reenactment", citing as authority this Court's decision in Helvering v. Winmill, 305 U.S. 79 (1938). (App. 54a.) The court found that the Internal Revenue Service had decided in 1952 to stop treating the earnings component of trust distributions to employees as "compensation" and that Congress had endorsed the change in policy by subsequently enacting into law "narrow exceptions" to the policy. (App. 4a, 46a-69a.)

The change of policy was set forth in a 1952 Internal Revenue "mimeograph" which stated that the Service would no longer treat the earnings component of trust distributions as "compensation" or "earned income" when paid to persons working outside the United States. I.R.-Mim. 71, 1952-2 C.B. 170. In 1960, 1966, and 1980 Congress amended the Internal Revenue Code to create exemptions from taxation for pensions and annuities earned by nonresident aliens in specified circumstances, such as when they worked for the

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[1] These cases are summarized in the Reasons for Allowance of the Writ, *infra* at 9-12.

United States Government. The court inferred from these exemptions that Congress endorsed the policy of the 1952 mimeograph as it applied to any trust distribution not covered by one of the exemptions, including petitioners' distributions.[2] (App. 65a-69a.) Although the 1952 mimeograph was not mentioned in the legislative history of the amendments and had been revoked in 1972, the Court of Federal Claims held that this did not controvert the "presumption" that Congress understood the scope of Internal Revenue Service taxation policy. (App. 65a.)

B. The Tax Treaty Question.

Article XV of the Income Tax Treaty between the United States and Canada (supra at 2) provides that only the taxpayer's country of residence may tax "salaries, wages and other similar remuneration" from employment exercised in that country. Because the parties in this case stipulated that petitioners exercised their employment only in Canada, it was undisputed that only Canada could tax petitioners' distributions if the distributions were "salaries, wages and other similar remuneration".

The treaty does not define "salaries, wages and other similar remuneration", but Article III provides that words not defined by the treaty will have the meaning they would have under local law. The Court of Federal Claims found that, as used in the Internal Revenue Code, the term "remuneration"

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[2] The exemptions were for certain types of pensions and annuities. Petitioners' distributions were not pensions or annuities because they were paid in a single installment. Internal Revenue Service regulations define "annuity" as a series of payments over a period of years. Treas. Reg. § 1.72-1(b). A "pension" is defined as a series of payments after retirement. Id. § 1.401-1(b)(1)(i).

did include the earnings component of petitioners' distributions, leaving the question whether the remuneration was "similar" to salaries or wages for treaty purposes. (App. 71a.)

United States law does not define the word "similar" or provide any rules for determining when one payment is "similar" to another. Nevertheless, the courts below reasoned that, because of Article III, United States "tax policy" should govern whether petitioners' distributions are "similar" to salaries and wages. (App. 5a, 71a-72a.) The court concluded that the earnings component of petitioners' distributions were not "similar" to other forms of remuneration because the Internal Revenue Service does not recognize the earnings component as compensation. (Id.)

On appeal, petitioners contended that the trial court's interpretation of the treaty was inconsistent with the relevant Commentaries of the Organization for Economic Cooperation and Development (OECD) on the OECD's Model Tax Convention. The U.S.-Canada treaty is based on the Model Tax Convention of the OECD, and the phrase "wages, salaries and other similar remuneration" comes directly from the Model Convention. The official OECD Commentaries on the Model Convention, to which the United States is a party, state that remuneration is "similar" to salaries and wages for treaty purposes when it is paid to an employee, as opposed to an independent contractor. Since petitioners were employees when they earned and received their distributions, they contended that their remuneration from the trust was similar to salaries and wages in the sense intended by the treaty. Although the OECD Commentaries were discussed in the appeals briefs and during oral argument, the opinion of the court of appeals does not consider them.

REASONS FOR ALLOWANCE OF THE WRIT

1. The Federal Circuit's Decision Conflicts with Decisions of Other Circuits.

For a variety of reasons, persons who perform services may be paid in part from a trust that is funded by the service recipient. For example, the Employee Retirement Income Security Act of 1974 requires that employee compensation that is deferred until termination of employment *must* be paid from a trust funded by the employer. 29 U.S.C. § 1103(a).

Because trustees must invest any money they receive, payments from a trust will ordinarily derive partly from contributions by the service recipient and partly from earnings on those contributions. Whether the earnings component of the distribution is "compensation" is a question that does not answer itself. The question has been answered differently in different circuits and has not yet been answered by this Court.

The United States Courts of Appeals have examined payments to service providers from the earnings of a trust in a variety of circumstances. Except in the instant case, they have decided that the payments were compensation for federal income tax purposes. A plurality of the cases were decided in the Sixth Circuit, but decisions of the Second, Fourth, Fifth, and Eight Circuits are in accord.

Two cases decided by the Sixth Circuit happened to involve the same trust, which (coincidentally) had been established by Chrysler Corporation to hold stock for its employees. In the first case, Frazer v. Commissioner, 157 F.2d 282 (6th Cir. 1946), aff'ing 4 T.C. 1152 (1945), the trust was not a "qualified" trust at the time of the

distribution.[3] In the second case, Frazer v. Commissioner, 173 F.2d 225 (6th Cir. 1949), aff'ing 9 T.C. 435 (1947), the trust had become "qualified". The employees contended that their distributions were gain from the sale of stock, but the government argued that that the distributions were "compensation for personal services". Frazer v. Commissioner 4 T.C. 1152, 1157 aff'd 157 F.2d 282 (6th Cir. 1946). In both cases the Tax Court sustained the government's position and the Sixth Circuit affirmed.

In Monte Vista Burial Park, Inc. v. United States, 340 F.2d 595 (6th Cir. 1965), the service provider was not an employee but an independent contractor that provided cemetery maintenance services and was paid from a trust funded by the purchasers of burial plots. As in Frazer the taxpayer contended that the earnings component of the payments from the trust should be taxed as earnings, and the Sixth Circuit sustained the government's contention that the payment of trust earnings to the taxpayer was instead "in the nature of compensation for its services". 340 F.2d at 597. On very similar facts the Fifth Circuit also decided that payments from trust earnings were "compensation" for the performance of services. Metaire Cemetery Association v. United States, 282 F.2d 225, 230 (1960).

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[3] "Qualified trusts" are "employees' trusts" that meet requirements specified by section 401 of the Internal Revenue Code. Treas. Reg. § 1.401-1(a)(3). If a trust is not qualified, the earnings are taxable with a deduction when they are distributed. Rev. Rul. 74-299, 1974-1 C.B. 154. If the trust is qualified, no tax is paid on the trust earnings and no deduction is allowed when the trust distributes the earnings. I.R.C. § 501(a). The Internal Revenue Service position is that the earnings component of a pension is taxable whether or not the trust is "qualified". IRS Pub. No. 519, U.S. Tax Guide for Aliens (1996) at 22.

In Sheet Metal Workers Local 141 Supplemental Unemployment Benefit Trust Fund v. United States, 64 F.3d 245 (6th Cir. 1995), employees received distributions from a terminated trust funded by their employer, and the Sixth Circuit sustained the government's contention that the portion attributable to trust earnings was wages for tax purposes.[4] On similar facts, the Second, Fourth, and Eighth Circuits reached the same conclusion. Lane Processing Trust v. United States, 25 F.3d 662 (8th Cir. 1994); NYSA-ILA Container Royalty Fund v. Commissioner, 847 F.2d 50 (2d Cir. 1988); STA of Baltimore-ILA Container Royalty Fund v. United States, 804 F.2d 296 (4th Cir. 1986). The facts in Lane Processing were almost identical to those of the instant case inasmuch as the trust had been funded by employer stock when the company was in financial difficulties and the earnings in question consisted of gain from the trustee's sale of the appreciated stock. 25 F.3d at 663-64.

Twice in the past this Court has been called upon to define the scope of what constitutes "compensation" for federal income tax purposes. In Commissioner v. Smith, 324 U.S. 177 (1945), the taxpayer had been granted the right to purchase his employer's stock at a fixed price and had done so after the stock's value had increased above the purchase price. The taxpayer contended that the appreciation should be taxed as capital gain, but this Court held that the appreciation was "compensation for personal services". Id. at 179-182. In United States v. Bayes, 410 U.S. 441 (1973), a health plan foundation had made payments into a trust that would pay

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[4] Although the issue in Sheet Metals was whether the earnings component was "wages" and not whether it was "compensation", the term "compensation" is defined under the Internal Revenue Code as including "wages". Treas. Reg. § 1.61-2(a)(1).

retirement benefits to the members of a medical partnership that served the health plan's subscribers. This Court held that there could be "no question" that the foundation's payments should be taxed as "compensation" for services rendered by the partnership. Id. at 449. In Bayes this Court did not need to decide, and did not decide, whether the retirement benefits themselves would have been "compensation" if they included earnings on the foundation's contributions. For that reason the courts below did not consider the issue in this case to be controlled by this Court's decisions. (App. 61a.)

When Bayes was decided there was no conflict between the circuits on whether the earnings component of trust distributions was compensation for tax purposes. Now that there is, petitioners pray this Court to grant the writ of certiorari and bring the line of reasoning in Smith and Bayes to its logical conclusion.

2. The Decision Below Misstates this Court's Holdings on the Doctrine of "Legislative Reenactment".

In 1928, when Congress first provided for employees' trusts that held employer stock, the legislative history stated that amounts distributed from dividends and any other income of the trust would be taxable as compensation in the hands of the employees. H.R. Rep. No. 2, 70th Cong., 1st Sess. 22 (1927). In the instant case, the courts below found that the Internal Revenue Service had adopted a different interpretation in 1952 and that this new interpretation acquired the force of law when Congress subsequently enacted legislation that precluded the taxation of some, but not all, of the distributions covered by the 1952 interpretation.

The 1952 interpretation was contained in a "mimeograph" which stated that the earnings component of distributions

from qualified trusts to citizens and aliens working overseas would no longer be treated as "compensation" or "earned income". I.R.-Mim. 71, 1952-2 C.B. 170. The 1952 mimeograph was a nonbinding[5] policy statement that interpreted provisions of the 1939 Internal Revenue Code. Id. In 1972 the Internal Revenue Service declared that the 1952 mimeograph and several other rulings that interpreted the 1939 Code were obsolete and "not determinative with respect to future transactions". Rev. Rul. 70-278, 1970-1 C.B. 281.

The Service has published two revenue rulings under the 1954 Code that deal with the issue of trust earnings. A 1959 ruling states that the earnings component of "annuity payments" to citizens working outside the United States will not be treated as "earned income", while a 1979 ruling states that the earnings component of "pensions" paid to nonresident aliens working outside the United States will not be treated as "compensation".[6] Rev. Rul. 59-278, 1959-2 C.B. 174; Rev. Rul. 79-388, 1979-2 C.B. 270.

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[5] Internal Revenue Service interpretations fall into two categories: (1) regulations and revenue rulings, which the Service regards as *binding* on itself and on taxpayers, and (2) mimeographs, memoranda, and other interpretations that provide *nonbinding* guidance to revenue agents and taxpayers. E.g., McBride v. Commissioner, 23 T.C. 901, 910 (1955). A "mimeograph" interpretation "has no binding or legal effect and may be changed, or ignored, either prospectively or retroactively". Id.

[6] Internal Revenue Service Publication 519, which provides nonbinding guidance to nonresident aliens, has stated since 1978, in a section entitled "pensions and annuities", that the earnings component of "pensions" to nonresident aliens are taxable as income from United States sources. (App. 55a-56a.)

In 1960, 1966, and 1980 Congress amended sections 402, governing the civil service pension plan, and section 871, governing taxation of nonresident aliens, to limit the taxation of pensions and annuities to nonresident aliens. The net effect of these changes is that pensions paid to government employees who work outside the United States are not taxable at all, while annuities paid to nonresident aliens are not taxable unless the alien's country taxes annuities paid to United States citizens and nonresident aliens make up more than 10% of the plan's participants. I.R.C. §§ 402(e)(2), 871(f).

Although the binding revenue rulings issued in 1959 and 1979 were limited to pensions and annuities, the 1952 mimeograph was not. The question presented to the courts below was whether, in restricting the policy of taxing pensions and annuities set forth in the binding revenue rulings, did Congress thereby endorse the broader policy of taxing all trust distributions, set forth in the nonbinding 1952 mimeograph. The committee reports for the amendments refer neither to the 1952 mimeograph[7] nor to the later revenue rulings but simply state that the earnings component of "annuities", "pensions and annuities", or "pensions in the form of an annuity" are treated as income from sources within the United States. S. Rep. No. 1028, 86th Cong., 2d Sess. 2,

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[7] The trial court found that a reference in a committee report to "annuities and certain other retirement benefits" was evidence that Congress knew about the 1952 mimeograph when the civil service pension rules were amended in 1960. (App. 48a-49a.) However, it is apparent from the court's own quotation that this language referred only to the scope of the Code section being amended, whereas the reference to taxation of earnings speaks specifically of a "pension" or an "annuity". (Id.) Also, the 1952 mimeograph never uses the term "retirement benefits". I.R.-Mim. 71, 1952-2 C.B. 170.

1960-1 C.B. 822; S. Rep. No. 1707, 89th Cong., 2d Sess. 27, 1966-2 C.B. 1059; S. Rep. No. 1036, 96th Cong., 2d Sess. 607, 1980-2 C.B. 723.

Although all Internal Revenue publications other than the revoked 1952 mimeograph refer only to taxing pensions and annuities, government counsel asserted that the Service's policy continued to be one of taxing all trust distributions, and the Court of Federal Claims held that there was a "presumption" that Congress knew the full scope of Internal Revenue Service policy. (App. 65a.)

The Court of Federal Claims cited this Court's decision in Helvering v. Winmill, 305 U.S. 79 (1938) as authority for its application of the "legislative reenactment" doctrine. (App. 54a.) Winmill holds that "Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to receive Congressional approval and have the effect of law". 305 U.S. at 83.

This Court's "legislative reenactment" doctrine does not have the scope imputed to it by the courts below. Winmill is only one of several decisions by this Court concerning the scope of the doctrine, and to state the doctrine without reference to the entirety of this Court's jurisprudence is to misstate the doctrine. The doctrine is ordinarily limited to *binding* administrative positions, Helvering v. New York Trust Co., 292 U.S. 455, 468 (1934), a limitation particularly appropriate in the complex area of federal income taxation.[8]

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[8] In a single recent decade (1981-1990) the Internal Revenue Service issued 3,088 *binding* regulations and revenue rulings and 57,998 *nonbinding* memoranda, announcements, etc. The Guidance Deficit: An Ongoing Statistical Study, Tax Notes Today (June 24, 1996) (LEXIS FEDTAX lib., TNT file, 96 TNT 123-83).

The doctrine also requires an inquiry into whether the administrative interpretation was long and consistently held. Watts v. Alaska, 451 U.S. 259, 272 (1981). Yet in this case, when Congress first purportedly approved the interpretation in 1960, the 1952 interpretation had been in place only 8 years and had replaced a contrary interpretation that had been in force for 27 years.[9] Even the Court of Federal Claims acknowledged that the Service's position had "vacillated" during the decade before Congress last amended the relevant Code provision. (App. 57a.) The legislative reenactment doctrine is also not applied to clarify a position on an issue subject to conflicting judicial and administrative interpretations. Aaron v. S.E.C., 446 U.S. 680, 694 fn. 11 (1980). Jones v. The Liberty Glass Company, 332 U.S. 524, 534 (1947). As noted supra at 12, the Tax Court and several Courts of Appeal had for decades held uniformly that the earnings component of trust distributions to service providers was compensation for tax purposes.

3. The Matter and Questions Presented are Important.

One consequence of the globalization of the United States economy is that millions of United States citizens find themselves working for foreign companies while millions of nonresident aliens find themselves working for United States companies. No one questions that the salaries and wages of these employees will be taxed only in the country where they live and work. However, when they change employers or

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[9] The 1952 mimeograph revoked a 1925 ruling which held that the entire amount of pensions paid to citizens overseas was "earned income". See Mim. 3283, VI-1 C.B. 14, declared obsolete, Rev. Rul. 67-406, 1967-2 C.B. 420.

retire, a large percentage of them become entitled to payments of various kinds from trusts established and funded by their employers. If distributions to nonresident aliens take the form of a pension or annuity, the 1980 amendment to section 871 prohibits taxation unless their own country taxes United States citizens on annuities earned in the United States. I.R.C. § 871(f)(2)(A). Canada, for one, does not.[10]

The precise number of foreign employees impacted by the decision below, if it is allowed to stand, cannot readily be calculated, but the impact is certainly immense. This case alone directly affects 6,200 employees of a single United States company. According to Internal Revenue Service figures, employers in 1992 reported paying $185 million of United States source pensions and annuities to nonresident aliens.[11] The Service does not publish figures for trust distributions other than pensions and annuities, but a reasonable assumption is that the amounts not distributed as pensions or annuities are equal to or greater than the amounts distributed as pensions and annuities.[12]

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[10] Canadian Income Tax Act, Part XIII, § 212(h); Revenue Canada Income Tax Regulation IT-76R2.

[11] Internal Revenue Service, SOI Bulletin 29, Figure B (Spring 1995) The figures do not break this figure down between income attributable to contributions for services performed in the United States and income attributable to earnings on contributions.

[12] According to the United States Department of Labor, in 1991 United States employers contributed $30 billion to defined benefit plans (all of which are pension plans) and $81 billion to defined contribution plans (most of which are not pension plans). Department of Labor, PWBA Office of Research and Economic Analysis, "Abstract of 1991 Form

If the decision below is not overturned, the United States will stand nearly if not completely alone in taxing the fruits of labor performed by aliens working in their own countries. While standing apart from international norms of taxation is not *per se* unlawful, it is unlawful if the United States has bound itself to those norms by treaty, as it has in this case.

The U.S.-Canada tax treaty, whose application to this case is undisputed, is expressly based upon the Model Tax Convention of the Organization for Economic Cooperation and Development. S. Exec. Rep. T, 96th Cong., 2d Sess. iii, vi. (1980); S. Exec. Rep. No. 8, 96th Cong., 1st Sess. 80, 95 (1979). Article 15 of the Model Convention (supra at 2) provides that "salaries, wages and other similar remuneration" can only be taxed by the country where the employee resides unless he actually worked in the other country. Article XV of the U.S.-Canada Tax Treaty comes verbatim from Article 15 of the Model Convention,[13] as does the comparable article of 31 other United States tax treaties.[14] The decision below, which interprets Article XV, potentially affects all citizens of those countries who work for United States companies.

5500 Annual Reports", Private Pension Plan Bulletin Number 4 (Winter 1995).

13 See Organization for Economic Cooperation and Development, 1963 and 1977 OECD Model Income Tax Treaties and Commentaries [hereinafter OECD Treaties] XX (1987).

14 Argentina, Australia, Austria, Bangladesh, Belgium, Bulgaria, China, Cyprus, Czech Republic, Finland, Germany, Hungary, Indonesia, Italy, Kazakhstan, Korea, Mexico, Morocco, Netherlands, New Zealand, Norway, Portugal, Romania, Russia, Slovak Republic, Spain, Sri Lanka, Sweden, Tunisia, Ukraine, United Kingdom.

The Court of Federal Claims held that petitioners' distributions, including the earnings component, were "remuneration" as that term is used in the Internal Revenue Code, but reasoned that they were not "similar" to salaries and wages because the Internal Revenue Service did not treat the earnings component as compensation. (App. 5a, 71a-72a.) That is an extraordinary conclusion given that four other courts of appeals had expressly decided that the earnings component of trust distributions to employees were "wages". See cases cited supra at 8-12. Nevertheless, the more consequential error was to rely upon United States "tax policy" to discern the meaning of Article XV.

It is black-letter law that unilateral interpretations of treaty terms should be given "little or no weight" unless there is evidence that the treaty partner was aware of and approved the interpretation when the treaty was signed. The American Law Institute, Federal Tax Project, International Tax Aspects of United States Income Taxation II 48-52 (1992). However, because treaties are agreements between two parties, evidence of *mutual* understandings is entitled to "substantial weight". Id. at 52-54.

When the OECD approved the Model Convention, it also approved official "Commentaries" on the provisions of the Convention. According to the American Law Institute:

> While the OECD materials undoubtedly do not rise to the level of customary international law, they occupy a unique position in the hierarchy of international tax materials. In practice both administrators and tax advisors automatically consult these materials when attempting to understand the meaning of treaty provisions. It would be wholly unrealistic, at least in the absence of strong evidence to the contrary, to think that treaty negotiators who adopted language derived from the OECD text were not familiar with

> and therefore did not knowingly accept the common meaning of that language as agreed among the OECD member countries.

Id. at 54. The high courts and appellate courts of our treaty partners regularly defer to the OECD Commentaries when they explain a treaty term. See, e.g., Thiel v. Commissioner of Taxation (1990), 171 C.L.R. 338, 349-50, 356-57 (Australia); Sun Life Assurance Co. of Canada v. Pearson, (1986) S.T.C. 335 (U.K.); Taran Furs Inc. v. The Minister of National Revenue, 1995 LEXIS 5665 (Canada).

The phrase "salaries, wages and other similar remuneration" originated in the 1963 Model Convention, which was successor to the League of Nations Model Treaty. Staff of the Joint Committee on Internal Revenue Taxation, 4 Legislative History of the United States Tax Conventions 4381 (1962). The League of Nations treaty had only a single article dealing with services, and a major innovation of the Model Convention was to split this article into separate articles on payments for "dependent services" (e.g. employees), payments for "independent services" (e.g., independent contractors), payments for services to governments, and pensions and annuities. Id. at 4528-29. The phrase "salaries, wages and other similar remuneration" appears only in the article on dependent services. In describing the creation of separate articles for dependent and independent services, the Commentaries on the 1963 Convention explain that that the purpose of the drafting committee was "to standardize the rules applying respectively to income from professional services and to remuneration from employment in the form of salaries, wages or the like (including pensions)". Id. at 4528. Thus, the intended "similarity" to salaries and wages was in the employment status of the payee, not the mode of payment. The fact that the drafters understood the phrase to include "pensions"

proves absolutely that the phrase was not intended to exclude payments that might include a component of trust earnings.[15]

That this multilateral understanding of the phrase "salaries, wages and other similar remuneration" remains the current understanding was recently demonstrated. Originally, Article 19 of the Model Convention, which covers services to governments, referred simply to payments of "remuneration". See OECD Treaties, supra n.11 at XXII. In 1994 Article 19 was amended by replacing the word "remuneration" with the phrase "salaries, wages and other similar remuneration". See OECD Committee on Fiscal Affairs, Model Tax Convention on Income and Capital M-34 (1994). The 1994 Commentary states that the phrase includes pensions and that the purpose of using the phrase was to clarify that the article applied only to employees and not to independent contractors. Id. at C(19)-2 ¶ 2.1.

Even if United States "tax policy" were entitled to substantial weight in interpreting Article XV, this Court's jurisprudence would require that the contrary interpretation of the OECD Commentaries prevail.

> When a treaty provision fairly admits of two constructions, one restricting, the other enlarging rights which may be claimed under it, the more liberal interpretation is to be preferred.

Nielson v. Johnson, 279 U.S. 47, 52 (1929).

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[15] Further proof that the phrase "salaries, wages and other similar remuneration" does not exclude pensions and annuities is the fact that the article which contains that language, in both the Model Treaty and the U.S.-Canada treaty, is made "subject to" the article on pensions and annuities, a limitation that would be superfluous if the phrase alone excluded those types of payments.

CONCLUSION

Because the matter in this case is important and because the courts of appeal are in conflict on one of the questions presented, the writ of certiorari should be allowed.

Respectfully submitted,

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